ALBERTA LEGISLATURE

OFFICE OF THE AUDITOR GENERAL

STATEMENT OF LOSS TO THE PROVINCE FROM ITS INVOLVEMENT WITH GAINERS INC.

Alberta Legislature

Office of the Auditor General

The Hon. Ralph Klein,
President of the Executive Council

Members of the Legislative Assembly

I have the honour to transmit herewith a statement of the loss to the Province from its involvement with Gainers Inc. This statement was prepared in response to the request I received on January 10, 1994, pursuant to section 17(2) of the Auditor General Act.

I am pleased to acknowledge that I received full cooperation from everyone whose assistance I needed to complete this special duty.

Donald D. Salmon
FCA
Auditor General

Edmonton, Alberta
March 14, 1994

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I have estimated the loss to the Province from its involvement with Gainers Inc. to be $209 million. This loss incorporates all liabilities arising under guarantees and indemnities given by the Province in favour of Gainers, and all loans and contributions by the Province to Gainers.

In November 1993, the government announced the sale of Gainers and estimated that the loss to the Province from its involvement with Gainers was $172 million. The primary reason for my estimate of the loss differing from the government's estimate is that I have included an interest expense of $35 million. This expense was included in the Gainers financial statements. It equates to the Province's interest cost on borrowings to fund Gainers.

In preparing this statement of the loss to the Province, I have used the Gainers audited consolidated financial statements, Gainers' internal management reports, and correspondence between government entities and Gainers. I have not conducted interviews. The terms of reference for this special duty did not require an explanation of the reasons for the loss.

The loss to the Province has been calculated in three components as follows:

		In Millions	Page
Loss on takeover	1989	$ 46	4
Loss from operations	1989-1994	101	7
Loss on disposition	1994	62	12
Total estimated loss		$209	

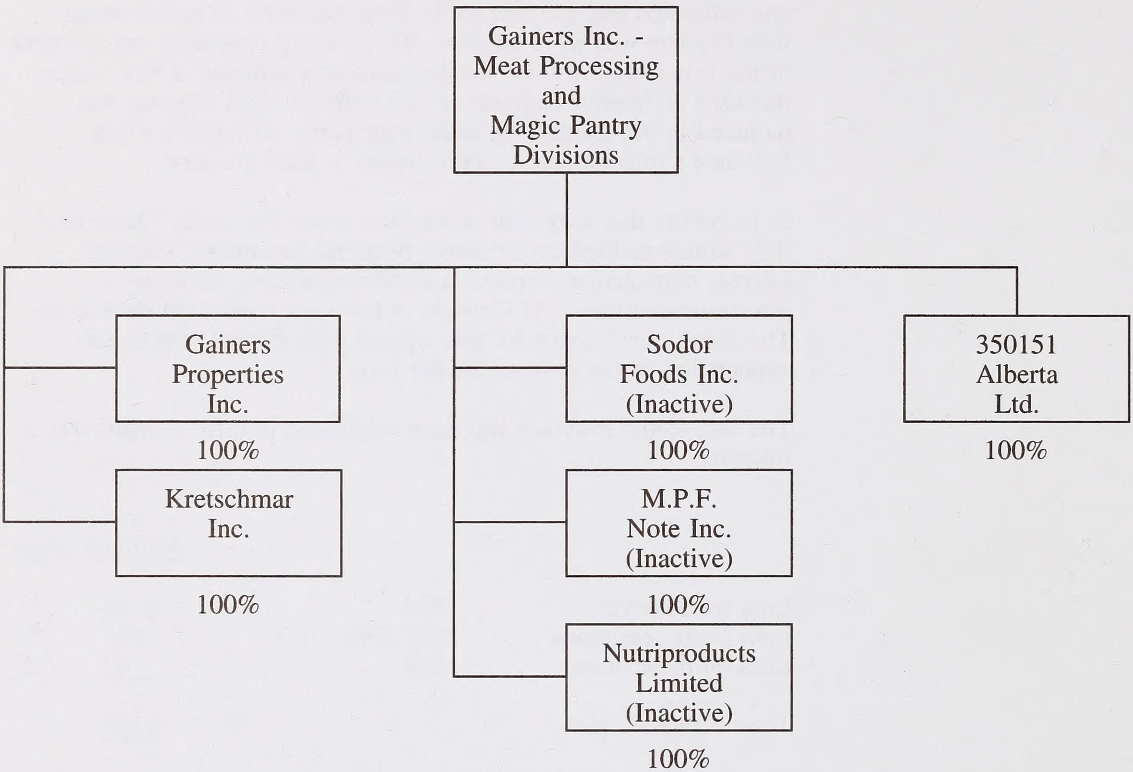
The calculation of the loss does not include possible future losses or recoveries arising from the outstanding lawsuits described in Schedule 6 since they are not determinable. Schedule 4 describes estimates made in calculating the loss.

Of the loss, $167 million has been included in 1992-93 and preceding years' consolidated financial statements of the Province. The balance will be included in the 1993-94 consolidated financial statements.

It should be noted that as early as January 1990, in an internal report prepared for the members of the Executive Council responsible for monitoring the Province's involvement with Gainers, it was estimated that the Province's exposure to loss was $143 million.

Organization of Gainers

On October 6, 1989, the Province took control of Gainers Inc. The takeover included Gainers Inc., the parent company, as well as Gainers Properties Inc., Kretschmar Inc., Sodor Foods Inc., M.P.F. Note Inc. and Nutriproducts Limited, referred to collectively as Gainers. The chart below shows the organization of Gainers as at October 6, 1989:



350151 Alberta Ltd. has not been included in the Gainers Inc. consolidated financial statements because ownership of this Company is in dispute. The third lawsuit referred to in Schedule 6 describes the dispute.

Description of Gainers' business

Gainers operated in the food processing industry. Its principal lines of business were as follows:

Meat processing

Gainers processed both cattle and hogs. The main facility located in Edmonton processed the meat with the exception of bacon which was processed in North Battleford, Saskatchewan.

In 1981, Gainers acquired the food business assets of Swift Canadian Co. Ltd., and in 1989, acquired the Swift trademarks for Canada.

Magic Pantry

This division of Gainers, located in Hamilton, Ontario, was acquired in 1985. Magic Pantry primarily manufactured dinner entrées for Nutri Systems and Jenny Craig (weight loss and health food centres).

Kretschmar Inc.

This Company, located in Toronto, was a wholly-owned subsidiary of Gainers Inc. Kretschmar manufactured processed meat items for delicatessen, retail and food service markets. Loblaws Companies Limited and McDonald's Restaurants of Canada were key customers.

Business environment

In order to understand Gainers' operating results, it is useful to have an understanding of the meat processing industry in Alberta. The following summarizes the views of Gainers' management and the conclusions reached in internal government reports regarding the meat processing industry.

Gainers processed approximately 50% of the hogs slaughtered in the Province. Fletcher's Fine Foods Ltd. was its only major competitor. Gainers also processed approximately 10% to 15% of the cattle slaughtered in Alberta.

In Gainers' internal reports, management characterized the past decade as a period of consolidation in the meat processing industry. The industry was evolving into one with fewer and larger competitors.

Industry consolidation, mature domestic markets and slow rates of population growth have made the markets more competitive. Industry publications indicate that sales of red meat had declined with the increase in per capita consumption of poultry. Gainers'

management took the view that expansion could only be obtained by capturing market share from competitors.

Most of the hogs processed in Alberta are purchased through the Alberta Pork Producers Marketing Board. The Board establishes hog prices in Alberta.

A draft discussion paper for the Development of a Strategic Plan for Gainers, dated November 1989, refers to a Federal Department of Agriculture report that states that Alberta had a competitive edge in Canada, with the 1989 Alberta cost per hog being $25 lower than Quebec and $12 lower than Ontario.

An internal government report in 1992 compared the cost of hogs in Alberta to the cost of hogs purchased by US plants. The report stated that during the five-year period 1987-1991, the average Alberta hog price was $18 less than the US price. However, the report indicated that labour costs were $1.45 per hog higher in Alberta. Further, US plants achieved a higher saleable output from each hog. More value-added processing, improved recovery of meat products, and the rendering of inedible products generated an additional contribution of $10-15 per hog. The report recognized that Alberta plants faced higher overhead costs and higher costs of shipping products to markets than US plants.

Loss On Takeover

The loss on the takeover of Gainers in 1989 amounted to $46 million and was made up as follows:

	In Millions
Net liabilities assumed	$35
Gain on settlement of Lloyds debt	(1)
Adjustment for investment in and amounts due from former affiliates	12
Total loss on takeover	$46

At the time of the takeover, Gainers' financial statements reported an accumulated loss of $35 million. Schedule 1 describes the makeup of the net liabilities of $35 million assumed by the Province on October 6, 1989.

Included in the liabilities was an amount of $36 million payable to Lloyds Bank Canada which was settled by the Province in the amount of $35 million thereby realizing a $1 million gain.

Included in the assets was an investment in and amounts due from former affiliates in the amount of $12 million. The first auditors' report on the consolidated financial statements of Gainers Inc. following the takeover contained a reservation of opinion on the value of this asset. Since the collection of this asset was in doubt from that time and is currently the subject of a lawsuit, I have included this amount in the loss on takeover by the Province.

Origins of the Province's involvement with Gainers leading to the takeover

September 1987	Master Agreement entered into with Alberta Treasury Branches. Gainers borrowed $55 million from Lloyds Bank Canada which was guaranteed by Treasury Branches.
July 1988	$55 million loan refinanced by The Yasuda Mutual Life Insurance Company under the security of a letter of credit issued by Mitsubishi Bank of Canada. The Provincial guarantee remained in place.
June 1989	Lloyds Bank Canada demanded repayment by Gainers of its operating loan. (The operating loan is not the same as the $55 million loan.) Gainers and Lloyds Bank Canada negotiated a delay in repayment.
August 1989	The Province acquired an option to purchase Gainers' indebtedness to Lloyds Bank Canada.
October 1989	The Province took over Gainers. The Gainers' debt of $36 million owed to Lloyds Bank Canada was purchased by the Province.

In September 1987, Gainers Inc., Mr. Pocklington himself as owner of Gainers, and Alberta Treasury Branches entered into a Master Agreement. The involvement of Treasury Branches was temporary since its guarantee provided under the Master Agreement was assumed by the Province under the authority of an Order in Council in March 1988. Also at that time, the Master Agreement was assigned to the Province.

The Master Agreement provided Gainers with a loan guarantee in the amount of $55 million, and contemplated the Province providing Gainers with a term loan of $12 million. In return, Gainers undertook to continue operation of substantially all of the Gainers Inc. red meat processing plants, to construct and operate an additional processing plant, to limit certain amounts paid to affiliated companies, and to pay promptly all amounts due.

In order to implement the Master Agreement, land, buildings and equipment owned by Gainers Inc. and Sodor Foods Inc. were acquired by Gainers Properties Inc. at an appraised value of $55 million. These assets were then leased back to Gainers Inc. and Sodor Foods Inc. The $55 million loan to Gainers from Lloyds Bank Canada became a liability of Gainers Properties Inc. This loan was secured by a $55 million guarantee issued by Alberta Treasury Branches. To cover its guarantee, Treasury Branches obtained a debenture from Gainers Properties Inc. pledging all of its assets.

The debenture was held for the benefit of Alberta Treasury Branches, and later the Province, by 369413 Alberta Ltd. This company holds in trust the Province's interest in Gainers. Under the Master Agreement, 369413 Alberta Ltd. also held debentures acknowledging that the assets of Gainers Inc. and Sodor Foods Inc. had been pledged.

In July 1988, the Lloyds Bank loan of $55 million was refinanced by The Yasuda Mutual Life Insurance Company. Gainers retained its operating and term loans with Lloyds Bank Canada.

Starting in 1988, Gainers drew on the $12 million term loan provided by the Province. Ultimately, a total of $6 million was borrowed under the term loan.

In June 1989, Lloyds Bank Canada demanded repayment by Gainers of its operating loan. In July 1989, Lloyds Bank and Gainers agreed that Lloyds would not enforce the security the bank held for the operating loan until October 1989. Gainers was to use this time to resolve its financial difficulties.

In August 1989, 369413 Alberta Ltd., on behalf of the Province, acquired an option to purchase all of the Gainers' indebtedness to Lloyds Bank Canada. The purchase price would be the total amount owed less a discount of $1 million.

In September 1989, Lloyds Bank Canada informed 369413 Alberta Ltd. that the Bank intended to realize its security.

The takeover

In a news release at the time of the takeover, the government stated that the takeover was necessary to "...protect a significant number of jobs for Albertans, give the company an opportunity to revitalize itself, and support an industry important to Alberta's diversification strategy." The government stated that it had the authority to take control of Gainers because conditions under the Master Agreement with Gainers had been breached as follows:

- Gainers had not paid interest on a term loan,
- Gainers had breached the terms of its agreement with Lloyds Bank Canada,
- Gainers had failed to commence construction of a hog plant in southern Alberta by September 30, 1989, and
- Gainers' group companies had not paid rent to Gainers Properties Inc.

Ownership of Gainers

On October 6, 1989, Gainers Inc. was in default of the Master Agreement. Under the terms of the Master Agreement, 369413 Alberta Ltd. acquired the shares of Gainers Inc. to be held in trust for the Province.

The Province paid $35 million to purchase the Lloyds debt effective October 6, 1989. Also in October 1989, the Province issued a loan guarantee in the amount of $10 million to the Canadian Imperial Bank of Commerce so that Gainers could obtain an operating line of credit.

In March 1990, the trust agreement under which 369413 Alberta Ltd. held 100% of Gainers was amended with the result that 369413 Alberta Ltd. held 90% of the shares in trust for the Province and 10% in trust for the management and employees of Gainers. The amendment, which was effective October 6, 1989, made Gainers Inc. a Crown-controlled organization. As a result, there was no statutory requirement for the government to make public the Gainers Inc. financial statements.

Loss From Operations

Operating results for the period October 6, 1989 to January 15, 1994

During the period from October 6, 1989 to January 15, 1994, when the operation of Gainers was under government control, the Gainers operating losses totalled $101 million.

The following amounts have been extracted from Gainers' internal management reports and have been reconciled to the audited financial statements.

	Year Ended 29-Sep-90	Year Ended 28-Sep-91	Year Ended 26-Sep-92	Year Ended 25-Sep-93	Period After 25-Sep-93	Total
			(in millions)			
Revenues						
Beef	$126	$125	$119	$100	$ 17	$ 487
Pork	100	92	96	108	32	428
Processed meats	163	169	161	158	46	697
	389	386	376	366	95	1,612
Magic Pantry	45	29	24	16	3	117
Kretschmar	46	48	44	48	13	199
Consolidation adjustment	(12)	(11)	(11)	(9)	-	(43)
	$468	$452	$433	$421	$111	$1,885
Profit contribution						
Beef	$ 5	$ 5	$ 5	$ 4	$ -	$ 19
Pork	13	16	16	14	5	64
Processed meats	24	26	27	25	7	109
	42	47	48	43	12	192
Magic Pantry	16	11	5	2	-	34
Kretschmar	9	10	10	8	1	38
Total profit contribution	67	68	63	53	13	264
Less:						
Interest payable to the Province	7	8	8	8	4	35
Other expenses	80	79	77	73	21	330
	87	87	85	81	25	365
Loss	$ 20	$ 19	$ 22	$ 28	$ 12	$ 101

Note: Profit contribution represents revenue less variable cost before interest and other expenses.

Meat Operations

Revenue from Gainers' meat operations (beef, pork and processed meats) declined over the term of Provincial ownership. Overall sales declined from $389 million in 1990 to $366 million in 1993. Gainers reduced its beef kill in 1992 and withdrew totally from beef sales in November 1993. Gainers' management viewed the profit contribution from beef as marginal. As a result of reducing its beef processing in 1992, Gainers reduced its accounts receivable and inventory levels, and remained within its operating line of credit.

Meat operation profit contributions increased from $42 million to $48 million in the period 1990 to 1992, but then declined in 1993 to $43 million. Gainers' management attributed this decline primarily to an increase in hog prices in fiscal 1993.

Profit contributions were not sufficient to cover interest and other expenses which declined from $87 million in 1990 to $81 million in 1993 as a result of corporate cost reduction efforts.

Magic Pantry

Magic Pantry sales declined from $45 million in 1990 to $16 million in 1993. Gainers' management attributed the decline in sales to the depressed state of the diet centre business in North America. As well, Magic Pantry was dependent on sales to its largest two customers. When purchases from these two customers declined, Magic Pantry was not able to replace those sales with sales to other customers. Gainers' management stated that due to concerns about the viability of Gainers, Magic Pantry customers turned to other sources of supply.

In 1990 and 1991, Magic Pantry contributed significantly to Gainers' overall profit contribution. The decline in Magic Pantry's operating results in 1992 and 1993 contributed to the deterioration of Gainers' overall results.

Kretschmar Inc.

Kretschmar sales remained between $44 million and $48 million and profit contributions remained between $8 million and $10 million for the fiscal years 1990 to 1993. In 1987, Kretschmar had acquired a five-year supply agreement with Loblaws which expired on December 31, 1992 and was not renewed. Kretschmar's other major customer was McDonald's Restaurants of Canada.

The Loblaws agreement comprised 64% of 1992 sales volume. After the expiration of the Loblaws agreement, Gainers had to bid for any contracts from Loblaws. Gainers' management stated that without the security of a supply agreement with Loblaws, profit margins could erode significantly. In 1993, sales increased by $4 million to $48 million but profit contributions decreased by $2 million to $8 million.

Comparison of consolidated budgeted and consolidated actual results

The amounts shown below have been extracted from consolidated internal budgets and from the audited consolidated financial statements of Gainers. For each year of ownership by the Province, a loss from operations was budgeted. Formal budgets were not prepared for 1994.

	1990	1991	1992	1993
		(in millions)		
Sales:				
Budgeted	*$477*	*$482*	*$504*	*$447*
Actual	468	452	433	421
Profit contribution:				
Budgeted	*$ 61*	*$ 65*	*$ 74*	*$ 65*
Actual	67	68	63	53
Loss for the year:				
Budgeted	*$ (22)*	*$ (18)*	*$ (13)*	*$ (5)**
Actual	(20)	(19)	(22)	(28)

* 1993 budgeted loss did not include the budgeted cost of interest on debt.

Sales in 1989, the year before the Province assumed ownership, were $505 million. Consolidated sales declined from this amount over each of the following four years. Gainers' management was able to achieve sales revenues within 10% of budgeted sales, except in 1992. The 1992 budgeted figures contain anticipated increases in sales volumes, primarily in the processed meat area. These expectations were not realized.

In 1990 and 1991, Gainers was able to reach its budgeted profit contribution goals. However, in 1992 and 1993 actual profit contributions were significantly short of budgeted amounts. In 1992, profit contributions were expected to increase by approximately 15%. It was hoped that aggressive marketing of processed meat would help to increase the profit contributions. These expectations were not realized.

Also in 1992, Gainers' management expected Magic Pantry sales volumes to return to 1990 levels despite continued weakness in the diet centre business. Magic Pantry sales actually declined a further $5 million from 1991 levels.

1993 budgeted results reflect decreased expectations in terms of sales and profit contributions. Sales figures were close to being reached, however, profit contributions continued to decline.

Capital expenditures and salary information

The following is provided to meet the request in the terms of reference from the Executive Council for information on capital investments made, and salaries paid, by Gainers.

Capital expenditures

Capital expenditures totalled $17.8 million in the period from October 6, 1989 to January 15, 1994, including $3.3 million purchased under capital leases. These purchases can be summarized as follows:

	In Millions
1990	$ 5.2
1991	6.2
1992	4.0
1993	1.8
1994	0.6
Total	$17.8

Over 90% of the purchases related to equipment.

Salary information

Schedule 7 provides information on salaries paid by Gainers for the 1990, 1991, 1992 and 1993 fiscal years.

Loss On Disposition

In January 1994, the Province sold the Gainers meat processing business to Burns Foods (1985) Ltd. Following this sale, the Province sold Kretschmar Inc. and the Magic Pantry Foods Division. The Province also repaid the Mitsubishi Bank of Canada loan.

The loss on disposition is made up as follows:

	In Millions	Schedule
Loss on sale of meat processing business to Burns	$42	2
Loss on sale of Magic Pantry Foods Division	4	3
Loss on sale of Kretschmar Inc.	6	3
Write down of land and buildings	4	
Interest penalty on prepayment of Mitsubishi Bank loan principal	6	
Total loss on disposition	$62	

Details of assets and liabilities remaining after the sales are shown on Schedule 4.

The disposition

In November 1993, when announcing the sale to Burns, the government stated that it had been its intention to provide Gainers with the opportunity to become profitable and to then return Gainers to the private sector.

Prior to Richardson Greenshields being contracted to find a buyer in June 1992, a number of informal attempts were made to sell Gainers. In July 1992, three potential buyers submitted proposals, none of which led to a sale. In April 1993, the government entered into negotiations with a fourth potential buyer which were discontinued in August 1993.

In March 1993, Gainers' bankers would only extend their operating line of credit to August 1993 on two conditions. The conditions were that the Province, as shareholder, had to inject $9 million into Gainers Inc. and that by May 1993, there should be evidence that either a merger or sale to a third party was progressing.

Sale to Burns

In November 1993, the Province announced that it had reached an agreement to sell Gainers to Burns, subject to certain conditions. The sale was finalized in January 1994.

The sale to Burns was effected through Pride of Alberta Meat Processors Company (a Limited Partnership referred to in this statement as Pride of Alberta). This Partnership acquired the meat processing businesses of both Gainers and Burns. Subsequently, Gainers transferred its interest in the Partnership to Burns. The Gainers meat processing business included all the assets, contracts, trademarks, and goodwill related to the business of processing meat.

Liabilities and certain specified assets such as the land and buildings in north Edmonton, shares in Kretschmar Inc. and assets of Magic Pantry, as well as the potential gains or losses on the outstanding lawsuits were excluded from the sale to Burns.

The asset sale value of $18 million was settled by Pride of Alberta by a cash payment of $8 million and the assumption of trade accounts payable and certain other liabilities to the extent of $10 million. Concurrently, Gainers made a $13 million payment to Pride of Alberta which has been treated as a reduction in the sales proceeds. In order to make the payment, Gainers borrowed $13 million from the Canadian Imperial Bank of Commerce. The borrowing was indemnified by the Province and on February 10, 1994, the Province paid the CIBC $13 million under the terms of the indemnity.

The loss on the sale of the meat processing business to Burns was:

	In Millions
Net book value of assets sold	$47
Less: Sales price	18
	29
Payment to Pride of Alberta	13
Loss on sale of meat processing business	$42

Schedule 2 contains a detailed calculation of the sale of the meat processing business.

Sale of Magic Pantry and Kretschmar

Certain assets and trademarks used in the operation of the Magic Pantry Foods Division were sold to Seenergy Foods Inc. for $1.6 million in January 1994. Kretschmar Inc. was sold to First Treasury Financial Inc. for $1.5 million in January 1994. The loss on these sales was $4 million and $6 million respectively. The

calculation of the loss on sale of Magic Pantry and Kretschmar is shown on Schedule 3.

Write-down of land and buildings

As stated above, certain land and buildings, with a book value of $4 million, were excluded from the sale to Burns. Site restoration costs are estimated to be at least $4 million, therefore, these assets have been written down to a nominal value.

Interest penalty on prepayment of Mitsubishi Bank loan principal

In January 1994, the Province prepaid the remaining $49 million principal sum owed to The Yasuda Mutual Life Insurance Company under the security of a letter of credit issued by Mitsubishi Bank of Canada. The total prepayment included a $6 million interest penalty, in accordance with the terms of the loan agreement, which has been treated as a loss arising on disposition.

Funding The Loss

On page 1, the total estimated loss to the Province from its involvement with Gainers is shown as $209 million. This loss was funded by the Province as follows:

	In Millions
Term loan under the Master Agreement and guarantee fees	$ 7
Payment to Lloyds Bank Canada	35
Payments to Mitsubishi Bank of Canada:	
Principal	55
Interest	33
Grant to Gainers Inc.	9
Indebtedness to Banque Nationale de Paris (Canada)	20
Payment to Pride of Alberta	13
Fees	2
Cash paid and to be paid by the Province	174
Interest on cash provided by the Province	35
Total funding by the Province	$209

Schedule 5 provides an analysis of the above funding year by year.

In general, Gainers' cash requirements were met from external borrowings which were guaranteed by the Province, and from cash provided by the Province. As Gainers did not have the cash flow

necessary to meet all of its obligations, the Province serviced its debt obligations. On the wind-up of Gainers, the Province will pay off the outstanding debt that it has guaranteed.

A brief explanation of the funding follows.

Term loan under the Master Agreement

On October 6, 1989, Gainers owed the Province $6 million advanced under the Master Agreement. Unpaid interest and guarantee fees at that date amounted to $1 million.

Payment to Lloyds Bank Canada

Gainers borrowed $55 million from Lloyds Bank Canada in September 1987. In July 1988, this loan was refinanced by The Yasuda Mutual Life Insurance Company under the security of a letter of credit issued by Mitsubishi Bank of Canada. In turn, the Province issued a guarantee to Mitsubishi. Interest and principal repayments on the $55 million loan are discussed below under the heading Payments to Mitsubishi Bank of Canada.

On October 6, 1989, Gainers owed Lloyds Bank Canada $36 million. On page 5, it is explained that this debt was purchased by the Province at a discounted value of $35 million.

Payments to Mitsubishi Bank of Canada

On November 1 and May 1 of each year, Gainers Properties Inc. was required to pay interest on the $55 million loan originally from Lloyds Bank Canada and later refinanced by Yasuda under the security of a letter of credit issued by Mitsubishi Bank of Canada.

The terms of the $55 million loan required the principal to be repaid by instalments of $2 million on May 1 of 1991, 1992 and 1993, by instalments of $3 million on May 1 of 1994, 1995, 1996 and 1997, and the balance of $37 million on May 1, 1998. Gainers Properties Inc. did not make the principal payments required in 1991, 1992, and 1993. During the period October 6, 1989 to January 15, 1994, the Province repaid the loan in full.

When the remaining principal sum of $49 million was prepaid by the Province in January 1994, an interest penalty of $6 million was incurred.

Grant to Gainers Inc.

The Province paid a grant of $9 million to Gainers Inc. in April 1993 in order to meet the requirements of Gainers' bankers for the extension of an operating line of credit (see below).

Indebtedness to Banque Nationale de Paris (Canada)

By May 1990, Gainers Inc. wanted its operating line of credit of $10 million from the Canadian Imperial Bank of Commerce to be increased to $14 million. Banque Nationale de Paris (Canada) paid out the CIBC line of credit and provided

Gainers an operating line of credit of $14 million. The Provincial guarantee remained at $10 million.

In August 1990, Banque Nationale de Paris (Canada) increased the operating line of credit limit to $28 million when Alberta Treasury Branches became a 50% participant in the loan. In an internal memorandum to its Executive Credit Committee, Alberta Treasury Branches staff stated that there was no obvious source of repayment aside from the liquidation/disposal of the Company and that barring a major turnaround in the industry, operating losses and capital expenditures would push the line of credit to its maximum in October 1991.

By September 1991, the balance on the operating line of credit had reached $23 million.

In July 1992, Banque Nationale de Paris (Canada) refused to increase the maximum for the operating line of credit above $28 million. Gainers Inc. reduced its beef kill and reduced its inventory. By September 1992, the balance on the line of credit was $26 million.

In March 1993, Banque Nationale De Paris (Canada) would only extend the line of credit to August 1993 on two conditions. The conditions were that the Province, as shareholder, had to inject $9 million into Gainers Inc. (see Grant to Gainers Inc. above) and that by May 1993, there should be evidence that either a merger or sale to a third party was progressing.

The operating line of credit was extended several times until December 1993. On December 17, 1993, the Province provided Banque Nationale De Paris (Canada) with an indemnity from losses on the line of credit in excess of the $10 million Provincial guarantee. As a result, Banque Nationale de Paris (Canada) released its security on the assets of Gainers Inc. which enabled the sale of assets to Burns.

It is estimated that the Province will be required to pay Banque Nationale de Paris (Canada) $20 million to settle the balance of the line of credit. Banque Nationale de Paris (Canada) will reimburse Alberta Treasury Branches the amount owed under their participation agreement.

Payment to Pride of Alberta

The sale agreement between Burns and Pride of Alberta required Gainers to make a $13 million payment to Pride of Alberta. Gainers borrowed $13 million from the Canadian Imperial Bank of Commerce to make the payment. The borrowing was indemnified by the Province.

Fees

The Province paid some of Gainers' legal and consulting expenses. Under the Master Agreement, all legal and consulting costs were required to be paid by Gainers. Those costs paid by the Province have been recorded as default expenses due to the Province in the Gainers financial statements. During the period October 6, 1989 to January 15, 1994 the Province paid $2 million in legal and consulting costs.

Interest on cash provided by the Province

During the period of Provincial ownership, the Province funded Gainers through the General Revenue Fund. Agreements between the Province and Gainers required that the Province charge Gainers Inc. interest on payments made to, or on behalf of, Gainers Inc. This interest amounting to $35 million was recorded as an expense in the Gainers Inc. financial statements.

I have not included in the loss any future interest because such cost cannot be reasonably estimated.

Schedule 1

Net Liabilities Assumed on Takeover

(based on the September 30, 1989 audited financial statements of Gainers Inc.)

(in millions)

Assets Acquired		
Current assets		
Accounts receivable	$ 25	
Inventories	22	
Prepaid expenses	1	$ 48
Investment in and amounts due from former affiliate (Note 1)		12
Capital assets		34
Other assets		3
Total assets acquired upon acquisition of Gainers Inc.		97
Liabilities Assumed		
Current liabilities		
Lloyds Bank Canada operating loan (Note 2)	(31)	
Accounts payable and accrued liabilities	(15)	
Interest on prior years' income taxes	(1)	(47)
Long-term debt		
Mitsubishi Bank of Canada loan, guaranteed	(55)	
Loans from Saskatchewan Economic Development Corporation	(3)	
Mortgage	(7)	
Note payable	(3)	
Lloyds Bank Canada term loan (Note 2)	(10)	(78)
Debt to the Province		
Term loan under the master agreement	(6)	
Accrued interest and guarantee fees	(1)	(7)
Total liabilities acquired upon acquisition of Gainers Inc.		(132)
Net liabilities assumed on takeover		$ (35)

Net Liabilities Assumed on Takeover

Notes to Schedule 1

Note 1 Investment In and Amounts Due From Former Affiliate

	(in millions)
Pocklington Corp Inc. - investment, at cost	$ 9
Pocklington Holdings Inc. - advances	3
	$12

Investment in Pocklington Corp Inc. comprises 77,500 Class A preferred shares with a par value of, and redeemable at, U.S. $100 per share and carrying annual non-cumulative dividends of U.S. $11 per share. Gainers Inc. demanded redemption of the shares in November 1989. To date, Pocklington Corp Inc. has not redeemed the shares. Gainers Inc. is suing Mr. Pocklington to recover the investment.

The advances to Pocklington Holdings Inc. are non-interest bearing and have no specific terms of repayment. In January 1990, Gainers Inc. brought an action against Pocklington Holdings Inc. to recover the advances.

Note 2 Lloyds Bank Canada Operating and Term Loans

Lloyds Bank Canada operating and term loans total $41 million as at September 30, 1989. By October 6, 1989, when the debt was purchased by the Province, the amount outstanding had been reduced to $36 million.

Calculation of Loss on Sale of Meat Processing Business to Burns on January 15, 1994
(in millions)

Negotiated sale price			$25
Adjustments (Note 1)			
Accounts receivable		$ (5)	
Inventories		(3)	
Other adjustments		1	
			7
Adjusted sale price			18
Less:			
Net book value of assets sold, before specific discounts:			
Fixed assets and capital leases	$18		
Accounts receivable	15		
Inventories	12		
Prepaid expenses and other assets	2		
		47	
Payment to Pride of Alberta		13	
			60
Loss on disposal			$42
Composition of loss on disposal:			
General discount		$17	
Specific discounts		12	
		29	
Payment to Pride of Alberta		13	
			$42

Settlement by Burns
(in millions)

Adjusted sale price		$18
Assumption of trade liabilities	$ 7	
Assumption of Saskatchewan Economic Development Corporation loan	2	
Assumption of other liabilities	1	
		10
Cash payment by Burns		$ 8

Note 1 The announced sale price was based on values of inventories and accounts receivable at August 28, 1993. The agreement stated that the price would be adjusted for the difference between the August 28 values and the actual values on closing. The agreement also provided for adjustments of other less significant items. The cash realized from the reduction of inventories and accounts receivable accrued to Gainers.

Calculation of Loss on Sale of Magic Pantry and Kretschmar
(in millions)

Sale of Magic Pantry
January 25, 1994

Sale price		$ 1.6
Less book value of assets sold (Note 1):		
Fixed assets and capital leases	$ 5.0	
Inventory	0.1	
		5.1
Loss on sale of Magic Pantry		$ 3.5

Note 1 The assets sold included property located in Hamilton, Ontario. The proceeds from the sale of the property were to be held in escrow for 45 days subject to the completion of a due diligence review by the purchaser. The review was to include assessing the existence of possible environmental problems.

Sale of Kretschmar Inc.
January 27, 1994

Sale price		$ 1.5
Less book value of net assets sold:		
Fixed assets and capital leases	$11.3	
Accounts receivable	2.7	
Inventories	2.5	
Other assets	0.2	
	16.7	
Liabilities	(8.9)	
		7.8
Loss on sale of Kretschmar Inc.		$ 6.3

Assets and Liabilities Remaining after Sales
(of meat processing business, Kretschmar, and Magic Pantry)

(in millions)

Bank indebtedness		$ 17
Accounts payable and accrued liabilities		5
Income tax payable		4
		26
Less:		
Accounts receivable	$ 4	
Other assets	2	
Land and buildings	-	
		6
Net liabilities due to others, Note 1		20
Liabilities due to the Province		182
Total net liabilities		$202

Note 1 Net Liabilities Due To Others

For the purposes of this statement, it has been assumed that the net liabilities due to others will be paid using the line of credit with Banque Nationale de Paris (Canada). In calculating the net liabilities, the following estimates have been made:

a) The potentially favourable results of any negotiations to settle liabilities at other than book value have not been recognized. Also, no estimate has been made for legal and administrative costs to be incurred during the final wind-up of Gainers.

b) Income tax payable represents reassessments issued by Revenue Canada Taxation. Gainers has appealed these reassessments and has also applied for a remission order. The outcome of the appeals and the application for remission is not determinable at this time.

c) Accounts receivable and other assets are shown at amounts estimated by management to be recoverable.

d) The value of the remaining land and buildings less future site restoration or environmental costs, if any, is not determinable at this time. These assets, therefore, have been written down to a nominal value.

Funding the Loss
(in millions)

	Year Ended 29-Sep-90	Year Ended 28-Sep-91	Year Ended 26-Sep-92	Year Ended 25-Sep-93	Period After 25-Sep-93	Total
Term loan and unpaid interest and guarantee fees due under the Master Agreement	$ 7	$ -	$ -	$ -	$ -	$ 7
Lloyds Bank Canada	35	-	-	-	-	35
Mitsubishi Bank of Canada						
· Principal	-	2	2	2	49	55
· Interest	6	6	6	5	10	33
Grant to Gainers Inc.	-	-	-	9	-	9
Banque Nationale de Paris (Canada)	-	-	-	-	20	20
Payment to Pride of Alberta	-	-	-	-	13	13
Fees	1	-	-	1	-	2
Cash paid and to be paid by the Province	49	8	8	17	92	174
Interest on cash provided by the Province	7	8	8	8	4	35
Total	$56	$16	$16	$25	$96	$209

Outstanding Lawsuits

The lawsuits referred to below relate to the takeover of Gainers by the Province. In addition, there are a number of lawsuits that arose in the normal course of Gainers' business for which possible future losses have not been included in the loss calculation because they are not determinable.

1. *369413 Alberta Ltd. and Alberta* v. *Peter Pocklington* (Action #8903 19038)

   Alberta alleges that Mr. Pocklington agreed to operate Gainers Inc. under the terms of the Master Agreement and the Pocklington guarantee. Alberta alleges it was forced to take over Gainers Inc. when Mr. Pocklington refused to remedy breaches of the Master Agreement. Alberta claimed about $37 million at May 31, 1991. Mr. Pocklington has counterclaimed for damages and indemnification.

2. *Pocklington, Edmonton Oilers Hockey Corp., Palm Dairies Limited and 350151 Alberta Ltd.* v. *Gainers Inc.* (Action #8903 21971)

   Mr. Pocklington *et al* claim indemnity from Gainers Inc. with respect to guarantees given on behalf of Gainers Inc. The Plaintiffs sought the appointment of a receiver of the receivables of Gainers Inc. to protect the indemnity which each claims from Gainers Inc. The suit is for $1.5 million.

3. *369413 Alberta Ltd. and Alberta* v. *Peter Pocklington* (Action # 8903 24686)

   Alberta alleges that Mr. Pocklington induced Gainers Inc. to breach the Master Agreement by selling shares of 350151 Alberta Ltd. to Pocklington Holdings Inc. ("PHI"). The amount of the suit is $1.9 million. PHI has filed a counterclaim alleging damages of $15 million should PHI be compelled to return the shares of 350151 Alberta Ltd. This action will be tried with action 9003 00854. (See #4, below.)

4. *Gainers Inc.* v. *Pocklington Holdings Inc.* (Action #9003 00854)

   Gainers Inc. alleges that its former parent, Pocklington Holdings Inc., owes it more than $3.2 million under a series of inter-corporate transactions. Pocklington Holdings Inc. has counterclaimed for $15 million alleging that if successful in the action, Gainers Inc. and the Province of Alberta would be unjustly enriched. This action will be tried with action 8903 24686. (See #3, above.)

5. *Gainers Inc.* v. *Peter Pocklington* (Action #9003 13025)

   Gainers Inc. alleges Mr. Pocklington broke his fiduciary duty to Gainers Inc. by arranging transactions that resulted in Gainers Inc. holding 77,500 preferred shares in Pocklington Corp. Inc. Gainers Inc. claims damages of U.S. $7,750,000 plus interest. Mr. Pocklington has counterclaimed for indemnification and solicitor/client costs, alleging that Alberta contractually required Mr. Pocklington to make these investments.

Outstanding Lawsuits

6. *Pocklington Foods Inc.* ("PFI") v. *The Province of Alberta* ("Alberta") (Action # 9003 14825)

   PFI alleges that under the terms of the Master and Negative Pledge Agreements Alberta is obligated to pay PFI for the value of the shares of Gainers Inc. at the time of the takeover by Alberta of Gainers Inc. PFI claims the value of those shares is $61 million.

7. *Gainers Inc.* v. *Peter Pocklington* (Action #9103 00942)

   Gainers Inc. alleges Mr. Pocklington caused a Gainers Inc. pension plan to invest in the Alberta Prime Beef Limited Partnership. Gainers Inc. claims that Mr. Pocklington breached his fiduciary duty to Gainers Inc. leading to this action for approximately $100,000. Mr. Pocklington counterclaims indemnification from Gainers Inc. under the Business Corporations Act.

8. *Gainers Inc., Gainers Properties Inc., Alberta and 369413 Alberta Ltd.* v. *Peter Pocklington, Pocklington Financial Corporation, Pocklington Holdings Inc., Pocklington Foods Inc., Edmonton Oilers Hockey Corp., Pocklington U.S. Inc., Pocklington Corp. Inc., Kretschmar Foods Inc., Hongkong Bank of Canada, David Rattee, Donald Cameron, Vince Keyes, Grant Naylor, David Charnok, Roger King, and John Jefferson* (Action #9103 14818)

   The plaintiffs seek recovery of $38 million plus interest from the defendants. The claim arises from transactions that took place in 1985 and 1987. The plaintiffs allege the defendants breached fiduciary and other duties owed to Gainers Inc., its creditors and Alberta.

9. *Gainers Inc.* v. *Edmonton Oilers Hockey Corp.* (Action #9303 03939)

   Gainers Inc. claims about $49,000 plus interest and costs from the Edmonton Oilers Hockey Corp. ("EOHC"). The claim arises from an agreement by Gainers Inc. and EOHC to jointly indemnify Continental Insurance Company for a bond of indemnity issued for a lien claim. At issue is whether EOHC paid its share of the $175,000 settlement.

Salary Information

	1990 No.	1990 Total	1991 No.	1991 Total	1992 No.	1992 Total	1993 No.	1993 Total
Gainers Inc.								
Chief Executive								
Officer, Note 1	1	$ 343,000	1	$ 387,000	1	$ 349,000	-	$ -
Vice Presidents:								
Corporate Affairs	1	119,000	1	155,000	1	147,000	1	147,000
Finance	1	109,000	1	139,000	1	127,000	1	130,000
Operations	1	107,000	1	119,000	1	117,000	1	121,000
Other managers	12	952,000	12	1,069,000	9	880,000	8	706,000
Other salaried staff		13,532,000		14,465,000		14,862,000		13,401,000
Hourly staff		32,751,000		34,343,000		38,625,000		38,174,000
		47,913,000		50,677,000		55,107,000		52,679,000
Magic Pantry Division		8,585,000		5,870,000		5,796,000		4,062,000
Kretschmar Inc.								
Executive VP	1	137,000	1	161,000	1	153,000	1	131,000
Other employees		9,719,000		10,584,000		10,887,000		11,631,000
Total		$66,354,000		$67,292,000		$71,943,000		$68,503,000

Total amounts include salary, bonuses and employee benefits.

Note 1 In 1993, the services of Chief Executive Officer were provided by a national firm of Chartered Accountants. The former Chief Executive Officer, who left Gainers in October 1992, received $650,000 as a severance settlement.

Note 2 The number of employees has not been provided in some cases as Gainers had a significant number of seasonal and part-time employees. Records were not available to provide the information necessary to calculate the number of full-time equivalent employees.

THE PREMIER OF ALBERTA

January 7, 1994

Mr. D.D. Salmon, FCA
Auditor General
8th Floor, 9925-109 Street
Edmonton, Alberta T5K 2J8

Dear Mr. Salmon:

Pursuant to Section 17 (2) of the Auditor General Act, as President of the Executive Council, I advise that the Executive Council requests you to perform the following special duty:

1. To report on the financial results of Gainers Inc. Consolidated ("Gainers") from October 1, 1989 to completion of the sale of assets to a partnership controlled by Burns Foods, including:

   i) the revenues received by Gainers,
   ii) the expenses incurred by Gainers including purchases of livestock, wages and salaries, etc.,
   iii) capital investments made by Gainers, and
   iv) the losses incurred by Gainers together with an analysis of the makeup of the losses and how they were financed.

2. To report on the effect of Gainers on the consolidated financial position of the Province including:

   i) liabilities under guarantees and indemnities given by the Province in favour of Gainers, and
   ii) loans and contributions by the Province to Gainers.

3. To present a report on the special duty which you will make public in the same manner as your last section 17 (2) report.

Sincerely yours,

Ralph Klein

RK/cm

Legislature Building, Edmonton, Alberta, Canada T5K 2B7 Telephone (403) 427-2251 Fax (403) 427-1349

Alberta Legislature
Office of the Auditor General

January 10, 1994

The Hon. R. Klein
Premier
307 Legislature Building
EDMONTON, Alberta
T5K 2B7

Dear Mr. Klein:

Re: Special Duty Related to Gainers

I accept the request dated January 7, 1994 from the Executive Council under section 17(2) of the Auditor General Act to perform a special duty related to the Province's involvement with Gainers in accordance with the terms of reference in that request.

I assume that the Executive Council made the decisions to provide loans and guarantees, to take control, to continue to operate, and to finally dispose of Gainers. Therefore, the previous and current members of the Executive Council are in the best position to make public any information on these matters. I believe that the Government should take the responsibility to release any information on matters not covered in my report.

My staff will proceed immediately to work on this special duty. The work cannot be completed, however, until needed accounting information up to the date of the sale of assets to a partnership controlled by Burns Foods, and the audited financial statements as at September 30, 1993 are available. If all goes well, I believe a report on this special duty can be completed and released before March 31, 1994.

Yours truly

D D Salmon

D.D. Salmon, FCA
Auditor General

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